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TAGS: [ECON](#) [EFIN](#) [EINV](#) [PREL](#) [EI](#)
SUBJECT: IRISH ECONOMIC DOLDRUMS: THE GOVERNMENT'S RESPONSE.

Classified By: PEO Chief Ted Pierce. Reasons 1.4 (b/d)

¶1. (C) Summary: The Irish government's announcement that public finances have deteriorated rapidly has prompted a mid-year re-think on the government's budget. Driven by a construction-led downturn in the broader economy, the government will cut public spending this year by USD 660 million and next year by USD 1.5 billion. Our government contacts contend that the Irish economy will rebound after 2009 and that there is no plan to scale back significantly on capital spending. That said, at least one official admitted that the faster "global external factors" correct, the faster Ireland's economy will pull out of the doldrums. There is a lot of commentary here about what went wrong with the economy and what Ireland has to show for its Celtic Tiger days. Whether Ireland settles in to "normal" mature economy growth rates or something better may depend on the government's appetite for bold policy action. End summary.

Tax Receipts Down...

¶2. (C) On July 2, the Irish government announced that tax receipts were almost USD 2.25 billion below forecasts. The shortfall prompted the government to step up their borrowing program (three times more than planned) and to cut spending by USD 660 million this year and another USD 1.5 billion next year. Tax receipts fell due to a steep fall in fixed investment this year of 15 percent, led by a virtual collapse in construction activity. Pat McArdle, chief economist at Ulster Bank, told us that there are 20-25,000 unsold housing units on the market. The government is now forecasting economic growth of 0.5 percent this year. However, the forecast is for 2.25 percent growth in 2009 and then 4 percent in 2010.

...So Spending Cut

¶3. (C) The government's spending cuts will come from several sources. The government will, among other things, pare back the public sector payroll by three percent (which may require up to 5000 job losses), cut spending on health and education, and cancel pay increases for Ministers, senior civil servants, and judges. Robert Watt, Assistant Secretary at the Ministry of Finance and former Managing Director of Indecon (a leading economic think tank), said that the cuts were aimed at coming in under the three percent budget deficit limit as laid out in the EU's Stability and Growth Pact. He said that absent further unexpected deterioration in the economy, these cuts would achieve that goal.

Still, Challenges Remain

¶4. (C) Irish government officials told us that the Irish economy is fundamentally sound but that the pick-up in growth after 2008 is not a sure thing. Kevin Cardiff, Second Secretary General at the Department of Finance, said that construction numbers are very disappointing and there doesn't seem to be anything (e.g. consumer spending) that looks

capable of enabling the economy to bounce back in the short term. He added that Prime Minister Brian Cowen remains focused on containing public sector spending -- in particular wage growth -- but gave the impression that this was very much an uphill battle. Cardiff said that inflation is a bit of a worry but not because of the headline rate. Rather, it is eroding Irish competitiveness with its trading partners and will impact exports.

15. (C) Watt said that the government is laying the groundwork now for "sustainable growth" when the global economy picks up. Government policymakers have agreed to maintain capital investment expenditures, cutting only "non-essential" projects. He admitted that the government's forecasts for growth depended on a number of external assumptions, among them: that the euro depreciates against the dollar and pound; that the U.S. and European economies grow faster; and that the oil price stabilizes or falls. He agreed that if some or all of these did not occur, then the economy could be in for a longer lull than expected.

16. (C) Watt noted that, while the banks are taking a beating on the stock market, they have little exposure to sub-prime loans and they are adequately capitalized to withstand a downturn. A contact at the financial regulator confirmed this view. However, market watchers here worry that some of the bigger real-estate developers will go bust and negatively impact the banks' balance sheets. One contact told us of a developer who unsuccessfully tried to make his loan payments in the form of unsold and vacant apartments.

Time for Creativity?

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17. (C) Nevertheless, Watt remains bullish long-term on the Irish economy, especially if the government enacts the right policies. He said that there is a mood "at the top of government" that this crisis is an ideal time to be "innovative" and tackle some big issues. For example, he said that if the on-going Social Partnership talks do not result in a deal, then "maybe it's time to find a new model." (Note: the Social Partnership is the triennial agreement between the government, employers, and the trade unions on such issues as taxes and wage rates, among other things. The intent of these deals is to make markets more predictable, to generally limit industrial actions and wage growth, and to settle on an agreed stance on taxes. End Note). He also said that the government will "hold firm" on public sector wages and will institute a hiring freeze.

Comment

18. (C) Many Irish are asking, "What went wrong?", and some complain that the signature outcome of the Celtic Tiger days is increased prices on everything from houses to Guinness. This, of course, is a vast oversimplification, but Watt admitted that the government could have done more while the coffers were full. The economy will undoubtedly recover. But does the economy settle in at growth levels akin to those of other mature OECD economies or can Ireland re-invent itself again and sustain above-average GDP growth? The answer to this question may depend on how bold the senior government leadership chooses to be. A key first test will be whether the government holds the line on public sector pay and spending within the context of the Social Partnership talks.

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